

BEFORE THE  
DEPARTMENT OF TRANSPORTATION  
WASHINGTON, D.C.

DEPARTMENT OF TRANSPORTATION  
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DOCKET SECTION

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Comments of

KLM ROYAL DUTCH AIRLINES

In Response to Department of Transportation  
Advanced Notice of Proposed Rulemaking on  
Computer Reservation System Regulations

Docket No. OST-97-2881 - 37

COMMENTS OF KLM ROYAL DUTCH AIRLINES

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Dated: December 9, 1997

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**DATED: December 9, 1997**

**COMMENTS OF KLM ROYAL DUTCH AIRLINES**

The Department of Transportation, (the "Department") has initiated an Advance Notice of Proposed Rulemaking to determine whether it should continue or modify 14 CFR Part 255 computer Reservation Systems CRS Regulations which will expire on December 31, 1997, unless extended. KLM respectfully submits its comments as follows:

KLM believes it is clear that the CRSs continue to have excessive market power over airline participants and that, in large part, the terms of the airline participation are not subject to market forces. In this connection, the Department has set forth a number of specific questions. For the sake of brevity KLM will address those questions it deems most relevant.

***1. Should the rules be continued If so, for how long?***

Yes, despite their inadequacies, the Department's rules should continue as long as CRS vendors continue to exert their market power over participating carriers through non-negotiable contractual agreements. Furthermore, the rapid growth of CRS access through the Internet represents a new potential for that market power to be abused. Indeed, the speed of these new electronic developments suggests a need for a continuing regulatory review.

***Should another review be required and, if so, when?***

KLM urges the Department to continue the rules and closely monitor new developments on an on going basis, without regard to artificial deadlines.

***2. Have the rules been effective? Are the rules adequate and appropriate in light of technological changes, changes in business conditions in the airline and travel industries and the rise of Internet and on-line computer services that enable consumers to make bookings?***

On balance, the rules have been effective as compared to pre-1984 practices. However, in view of technological advancements and changes in airline and travel industry business conditions, the rules are at risk of becoming ineffective and inadequate to deal with current CRS vendors' anti-competitive abuse of market power. In particular, CRS costs now outweigh the benefits for airline participants in many CRS features. Nevertheless, carriers with even minor CRS equity interests are compelled to pay exorbitant prices to CRS vendors for often useless services and features.

**3. *In those areas where commenters believe that the rules have not been effective, should provisions be deleted or modified and, if modified, how? Commenters should address how the rules have been effective or ineffective in detail.***

KLM believes that the rules, as currently drafted, inhibit the action of market forces between CRS vendors and carrier participants. Limited provisions, such as Part 255.7(a), which tie reasonableness of CRS costs to the fees charged by other CRS vendors, do nothing to encourage price competition among CRS vendors. In fact, the rules effectively dictate that the CRS vendors charge participating carriers uniform, fixed prices. At the same time, the regulations provide no mechanism for introducing market forces into the pricing.

Consequently, CRS vendors combine their market power with the Department's price fixing regulations to force carriers to accept bundled functions and services. This in turn runs up CRS costs.

The Department can increase competitive market forces in the CRS industry by requiring CRS vendors to unbundle functions, services and markets and ensure that participating carriers are free to opt out of unwanted services and functions. In other words, granting each airline the right to negotiate the terms and conditions of each CRS Participating Carrier Agreement including, among other things, geographical participation, market segments and/or market volume.

Increasing the freedom of all CRS participants to choose the level of CRS service sufficient for their needs, irrespective of limited equity participation, would permit participating carriers to make individual choices that are essential to any free market.

Additional competitive forces can be introduced, by making it clear in any regulation that, individual carriers and their alliance partners are exempt from the identity requirements of the CRS regulations for direct sales through electronic channels that are not held out to be neutral. In this connection, it should be noted that this position has been adopted in Article 21c of the European Union Code of Conduct for Computer Reservation Systems.

- 4. Do the changes in ownership of the systems (all now have multiple owners and at least one is owned in part by the public) require changes in our approach to regulation or in individual rules? Should we reexamine our jurisdictional and analytical bases for regulating CRSs, which rely on the ownership of each system by one or more airlines and airline affiliates? Do the decisions by some airline owners to reduce their CRS ownership interests indicate that there is less need for CRS regulation?***

The Federal Aviation Act (49 USC 40102(a)2) grants the Department jurisdiction over anyone who undertakes, whether directly or indirectly, to engage in air transportation. This provides sufficient jurisdictional basis for the Department to regulate distribution of air transportation by electronic means, irrespective of whether or not the vendor operates aircraft. In this connection, it should be noted that the above-mentioned European Union regulations are not limited to carrier-owned systems.

The reduction in carrier ownership in CRSs is a function of, among other things, the fact that the Department's regulations have eliminated potential benefits for limited investments. Indeed, in many cases, the regulations create competitive handicaps to equity participation. Elimination of the CRS rules might quickly reverse this trend.

5. *Have the rules allowing travel agencies to use third-party hardware and software and to use terminals not owned by a system to access other travel databases had any impact? Should the rules be changed to make it easier for travel agencies to use third-party hardware and software and to access other databases? For example, should the exception allowing vendors to restrict the use of vendor-owned equipment be eliminated?*

Third-party software may have increased competition among CRS vendors for the travel agency subscribers. However, these-third party systems increase the non-revenue producing CRS transactions for which the participating airlines are forced to pay.

6. *Does the mandatory participation rule (section 255.7) strengthen or weaken competition in the airline and CRS businesses?*

As noted above, KLM believes that the single most important market force that can be introduced into the regulations is the elimination of the mandatory participation rule. Moreover, KLM believes that elimination of Part 255.7(a) should be combined with regulations against the bundling of CRS markets, services and functions to airline participants.

*Should the rule be modified to create areas where airlines with CRS ownership interests would have some ability to choose which services to buy from other systems? Should the rule instead be extended to cover airlines that market a system?*

KLM strongly supports a modified rule granting airline CRS owners/investors the flexibility to purchase selected services from multiple systems.

7. *In the parity clause rulemaking, Delta Airlines has contended that we should bar systems from requiring participation in the booking services offered through Internet sites as a condition to participation in the services offered travel agency subscribers. What impact would Delta's proposal have on airline and CRS competition?*

KLM supports the Delta Airlines proposal. We believe it would enhance CRS competition for airline business and have no adverse effect on airline competition. Indeed, CRSs should be prohibited from forcing carriers to participate in Internet based services. If CRS vendors are not allowed to use their market power to compel participation in service or systems, only then will market forces be introduced between CRS vendors and airline participants.

*Does the use of CRSs as booking engines by many Internet websites raise other issues that should be addressed in the rules?*

CRS access via Internet websites raises the issue of subscriber abuse. Namely, consumers booking one or more transactions on multiple CRSs, unaware that a participating airline is charged a fee for each transaction, irrespective of whether or not a ticket is issued. This issue should be addressed in the rules. Furthermore, the Department's non-bias rules governing schedules, fare displays and fees should be applied to Internet websites which claim to be neutral providers of air services. The Department's rules create an expectation of regulated neutrality which the rules currently do not fulfill.

CRSs should be required to provide airlines with point of sale controls. In the meantime, the existing CRS regulations mandating uniform fees and charges are pushing all such extraneous costs onto participating carriers. If the Department

continues to mandate uniform fees and charges, then it must prohibit CRS vendors from assessing fees and charges that do not result in a booking or other services contracted for by the participating airline.

**8. *Do the systems' display algorithms injure airline competition and, if so, how?***

The absence of fixed, neutral display algorithms reduces airline competitiveness. The Department regulations permit CRS vendors too much flexibility over their algorithms. This has not resulted in any competition among the CRS vendors to develop algorithms that benefit either participating carriers, travel agency subscribers or the public. Rather, this flexibility has resulted in uncertainty, confusion and suspicion of abuse. By contrast, in Europe, algorithms are based on fixed, neutral criteria which enable participating airlines, travel agents and the traveling public to choose among the various CRS vendor offerings on a fair comparison basis. While there may be various arguments for or against any specific fixed, neutral criteria, at least in the European Union, everyone is on the same level playing field. It should be noted that U.S. CRS vendors are using the European Union's criteria in Europe without any adverse effects.

In this connection, one of the biggest consumer complaints with deregulation is the confusion associated with choices. The Department's reluctance to set the basic fixed, neutral criteria contributes to that consumer confusion. KLM submits that, unless the Department acts, this confusion will only increase as more consumers directly access CRSs.

***If so, how could we prevent those injuries without engaging in a detailed regulation of the systems' criteria for editing and ranking their displays?***

KLM suggests that the Department's desire to avoid detailed regulation of the systems' criteria for editing and ranking their displays is misplaced form over substance. Like the Department, KLM would welcome a free market electronic airline distribution system devoid of dominant players with unfettered market power. Unfortunately, the fact is that regulation is required. Having established the need for regulation, and setting detailed requirements in all phases of the industry, the Department then seeks to avoid its responsibilities in the area of algorithms. This in turn increases consumer confusion and obviates many of the benefits of the existing regulations.

***9. Does our rule requiring each system to make available to participating airlines all of the marketing and booking data generated by the system from bookings (section 255.10) benefit airline competition?***

Yes, requiring CRS vendors to have system generated marketing and booking data available to participating carriers benefits airline competition by not limiting access to a privileged few.

***10. We adopted a rule that generally requires each system to make available to participating airlines the same functionality used by its owner airlines (section 255.5) Has this rule been effective?***

Yes, the equal functionality requirement has been effective.

***Are there any remaining significant differences in functionality that affect airline competition?***

European Union rules further regulate the equal functionality requirement by mandating de-hosting and audits. One important rule in this regard requires advance

notice of any new function. We believe the U.S. would benefit from adopting similar requirements.

***11. Should we address the issues of booking fee levels and the structure of booking fees?***

As noted above, booking fee levels and structures should definitely be addressed. Airlines have no power to negotiate CRS fees. Price structures and increases are not transparent. Participating airlines have no flexibility in controlling CRS expenses. Travel agencies engage in multiple booking practices generating excessive CRS fees for participating airlines.

***If so, is there a practicable method for regulating the level of booking fees?***

Article 10.1 of the EU Code of Conduct for Computer Reservation Systems states:

*“Fees charged by CRSs should be non-discriminatory, reasonably structured and reasonably related to the cost of the service provided.”*

The above provision should be incorporated into the U.S. rules and strictly enforced.

Additionally, the Department should consider:

- Prohibiting CRS vendors from imposing a booking fee for any transaction that does not result in actual airline travel.
- Requiring CRS vendors to provide participating carriers with appropriate information justifying any anticipated increase in fees.
- Requiring CRS vendors to establish standardized, bilateral billing policies for participating air carriers.
- Granting airlines the power to challenge CRS booking fees.

- Requiring CRS vendors to base any productivity pricing arrangement on the actual number of tickets issued.

***12. Do the systems inappropriately charge airlines for agency transactions that are unnecessary or valueless for airline participants?***

KLM submits that this issue is not in dispute. CRS vendors openly use their market power to charge without justification for unnecessary or valueless agency transactions which include: issuing a ticket on an overbooked flight, issuing a ticket with an improper fare and preparing an itinerary, accounting record or invoice.

***Do the systems use subscriber contract terms, such as productivity pricing, that may encourage unnecessary transactions by some agencies and lead to increased booking fee costs for airline participants?***

Yes, CRS vendors encourage travel agents to generate passive bookings by reducing or eliminating subscriber fees for travel agencies which generate a certain level of productivity. A participating carrier is charged a fee for every booking transaction, regardless if it results in a ticket. KLM submits that this is a function of the fact that CRS vendors have such massive market power over participating carriers. This is combined with the impact of CRS regulations which impose uniform prices without any limitations on costs. This results in competition among system vendors for agency subscribers that are in turn funded by the participating carriers. If the Department mandates fixed prices for participating carriers, it must also fix the ability of the system vendors to assess costs. A practical solution would require CRS vendors to charge on the basis of tickets issued, rather than booking transactions. This would eliminate a travel agency's incentive to generate passive bookings.

***If such problems exist, should we adopt rules in this area?***

Yes, rules should be adopted to prevent such abusive practices. A practical solution would be to require travel agency productivity incentives to be based on the total number of tickets issued for actual travel, rather than the total number of booking transactions.

***Parties commenting on this issue should explain why airlines can or cannot stop illegitimate or unnecessary travel agency transactions by taking action against travel agencies that choose to conduct such transactions.***

Despite repeated demands, participating airlines do not have the market power to convince CRS vendors to provide adequate point of sale or booking data to support any actions against abusive travel agencies. As a result, from the perspective of the participating carrier, each CRS is an effective monopoly with excessive market power.

***13. In the past we have reasoned that promoting the systems' competition for subscribers should usually promote airline competition, although increased competition for subscribers may lead to increased CRS costs for participating airlines. Does such competition among the systems benefit airline participants?***

Promoting CRS competition for subscribers does not promote airline competition.

It merely places more costs on the carriers.

***14. Some industry participants have asserted that some of the major airlines with CRS ownership interests coerce travel agencies at their hubs into using their systems and thereby unreasonably limit competition in both the CRS and airline industries. Are these assertions true?***

KLM believes that industry studies have demonstrated a natural tendency for travel agents to choose the system of the airline that is the dominant provider of air service in those agents' markets. As such, coercion is not a significant factor.

***If they are, are there any practicable rules that could be adopted that would limit or eliminate such practices?***

In any competition for a travel agency's loyalty in the hub market, the hub carrier simply enjoys a natural market advantage.

***15. The overseas marketing efforts of some CRSs have been frustrated by discriminatory conduct by foreign airlines and other travel suppliers that own or market a competing CRS in their home countries. Section 255.11(b) of our rules already exempts a CRS from complying with certain rule requirements in response to some types of discriminatory conduct by a foreign CRS. Should our rules be revised to strengthen a U.S. system's ability to take countermeasures against such discrimination?***

KLM submits that unilateral retaliation in foreign markets is not in the best interest of the United States or the international air transport community. In this era of global alliances, it is suggested that the U.S. government should demonstrate its leadership and work towards the establishment of uniform application of CRS rules in international air transport. In this connection, the U.S. should consider CRS discussions with other governments, such as the European Union.

**Respectfully submitted,**



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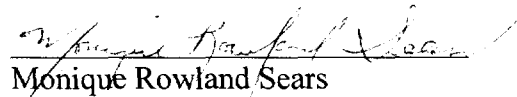
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December 9, 1997

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I hereby certify that I have this date served a copy of the foregoing Comments of KLM Royal Dutch Airlines on all persons named on the attached list by causing a copy to be sent via first-class mail, postage prepaid.

  
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